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SUBJECT: Mongolian State Procurement: New Law Bars Most International Bidders and Cuts Competition Requirements

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Ref: Ulaanbaatar 125

¶1. (SBU) SUMMARY AND COMMENT: In a candid recent conversation, a senior official of Mongolian Ministry of Finance told us that Mongolia's government procurement process has been problematic for years, due to the limited staff of the Ministry's Procurement Office, and the tendency of State Great Hural Members to load budgets up with pork barrel projects they push officials to award to their political and business cronies. However, things are set to get worse, just as Mongolia launches a major expansion of infrastructure projects using funds from the Windfall Profits Tax on copper and gold. In the final hours of its latest session, and without any public notice or S-Q-s! ects from competitive procedures if they are under the \$10 million threshold. End Summary.

Best Practice Procurement Comes to Mongolia

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¶2. (SBU) Following the events involved in the disputed solar power tender (reftel), the Ministry of Finance's Director General of the Procurement Policy and Coordination Department, Ms. Kh. Mart (strictly protect), explained to Commooff how Mongolia's government procurement system had evolved over the last 15 years and the current problems that threaten that system. For the last decade, Mart has worked in MinFin's procurement division, assisting with all aspects of reforming old and implementing new regulations. Specifically, she served as the GOM liaison with the Asian Development Bank as it provided extensive technical assistance on drafting the last major revision to the state procurement law from 1999-2000. (Note: Ms. Mart spoke candidly, noting that she is about to leave her position for other employment because of disillusionment.)

¶3. (SBU) Mart bluntly explained her willingness to discuss problems with state procurement. Having working so hard over the last 15 years to try to make Mongolia's state procurement system among the best in Asia and globally, Mart was extremely disappointed by the State Great Hural's (SGH) recent amendments to Mongolia's excellent Asian Development Bank (ADB)-sponsored procurement law. Mart saw these changes as clearly reversing the GOM's commitment to an open and equitable system and a return to an inefficient, corrupt system.

Comhoff noted to Mart that SGH had done the same with the amendments to the minerals law, imposing a system that allowed too much government intrusion and discretion into areas best served by commercial interests. Mart agreed that the trend seemed to be away from clear procedures and market forces to some sort of socialist, free-market hybrid that combined the worst aspects of both.

#### Paradise Found

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¶4. (SBU) Prior to 1991, Mart noted, Mongolia employed a Soviet-inspired and imposed system of government procurement, covered under the Budget Law of Mongolia. There was no need for a procurement law as the government was simply allocating resources it already owned and controlled through a socialist system that on paper yielded the most efficient, lowest cost results. The only matters to determine were development priorities and if sufficient resources were available for these needs. Based on the concept of five-year planning, projects were sent down from on high, money and material were allocated from the center, and projects were implemented. While not praising the socialist era's elaborate bureaucratic oversight apparatus, Mart noted that projects were completed, if not perfectly so.

¶5. (SBU) From 1991-2000, the GOM unsystematically abandoned aspects of the socialist procurement system. The ministries and the State Great Hural (SGH) would determine projects and budgets according to the law, but left implementation to respective ministries and agency

ULAANBAATA 00000160 002 OF 004

heads. Constrained only by the amount budgeted, the reigning bureaucrats controlled all other aspects of planning and execution with little or no oversight to prevent conflicts of interest, waste, fraud, and abuse, because oversight had collapsed in the early years of the transition. Mart stated that both budget and corruption levels raced up as the players had no check on their appetites. More importantly, vital development projects were not being completed at all.

¶6. (SBU) Recognizing that these institutional weaknesses were harming the state, elements within the GOM, supported by the donor community, pushed through key reforms in the late 90's, at first only for the large projects and then an ABD-led reform for the entire procurement system. Selecting from the best practices recommended by the UN, WB, and ADB, Mongolia passed procurement reform in the waning days of the Democratic Party's control over the GOM, leaving implementation to the MPRP government that followed. First, the new law embedded the legal concept of "procurement" into Mongolian law. Mongolian legal practice requires such legislating because, if a concept is not formally enacted into law, there is no legal obligation for anyone to follow any specific practice. Thus, prior to 2000, MinFin admonishments to officials about waste, fraud, and abuse in procurement had no legal force whatsoever. However, the 2000 Procurement Law enacted a legal concept and system against which the actions of GOM officials could be assessed and held accountable. Second, the new law divided procurement into three separate areas of responsibility: planning, oversight, and execution. These "Chinese walls" among the planning, oversight, and execution, were meant to preempt conflicts of interests in that had plagued state procurement in the 90's.

¶7. (SBU) The GOM proposes budgets and projects to the SGH for approval, but the SGH can and does add items to the budget. Mart noted that the SGH often has little or no solid planning on the initiatives it sends to the GOM. In an effort to mediate differences between the ministries and the SGH, an inter-ministerial council was established to meet on projects over US\$150,000. It was abolished in 2005, because ministries and members of the SGH simply used it as a means to tack on all sorts of extras to any procurement that came their way, busting budgets and making projects un-implementable.

¶8. (SBU) Once a project leaves initial planning, the individual ministries and agencies -- some 6000 entities -- fine tune their respective plans for procurement. Separate evaluation committees within each entity, charged with executing particular projects, submit the technical specifications for each project for intra-ministerial review by the relevant departments, including the

ministry's budget officers. These documents will become the tender package or request for proposals to follow. These evaluation committees then execute the procurement

¶ 9. (SBU) MinFin has the right and responsibility to review documents and processes to ensure consistency with the Procurement Law at all stages. As a practical matter, Ms. Mart and her staff of seven cannot possibly review all procurements conducted by Mongolia's 6000+ public entities. MinFin leaves most investigation to the State Audit Authority. Of the some 600 new projects over US\$150,000 executed in 2006, Mart noted that her team could only review 30 thoroughly, given the complexity of the projects. Thorough review will only occur on projects that exceed US\$3 million. Mart said she would look to increase that financial threshold because more and larger projects are coming down the pike, and she expects no increase in human resources to examine these projects.

¶ 10. (SBU) In assessing the procurement apparatus, Mart argues that she and her team are as professional and effective as possible given the circumstances faced. She is, however, less generous in assessing ministerial and SGH responses to the law. Regarding training of the SGH, Mart observed that its members seemed largely indifferent to MinFin's training in procurement techniques and issues. Regarding bureaucrats, in the early years of implementation the initial problem was that ministerial officers did not understand how to implement the legal requirements, especially how to draft project and tender specifications. Mart assisted with trainings she called

ULAANBAATAA 00000160 003 OF 004

basically successful, but noted that excessive employee attrition in the ministries that do most of the tendering (the Ministry of Health, for instance) lowers the value of such training. However, Mart believes that training efforts have still delivered a workable level of expertise but that more training is certainly needed. (Comment: Mart was obliquely criticizing a civil service system that provides no tenure or protection for its employees. In the case of the Ministry of Health, former Minister Gundalai fired most of the existing employees and experts, replacing them with his own nominees. Such wholesale firings left no one to train new employees in procurement methods.)

¶ 11. (SBU) Mart complained that poor planning and violations of the regulations have consistently plagued implementation of the procurement law. As most projects are proposed by SGH members, ministers and their respective political and business associates -- often one and the same, and none experts in the fields under consideration -- projects all too often lack details needed for budgets and specifications, slowing down execution of the project before it even gets to MinFin. Also, Mart often must send projects back for further planning because they routinely fail to comply with the law, causing further delays. Delays often cause cancellation as budgeted funds cannot be committed within the fiscal year.

¶ 12. (SBU) MinFin's refusal to sign off on poorly conceived and legally dubious projects has generated the most heat between Mart's department and other parts of the GOM: Ministers, department heads, SGH members and their associates angrily threaten her (sometimes with bodily harm) unless she relents, she said. She mentioned that the solar power tender that had generated post's initial interest in procurement (see reftel) had spurred much abuse from Minister of Fuel and Energy Erdenebat and his people at MFE against her and her team: demands that the MinFin accept MFE tender concepts and processes, even though neither followed the law. Mart asserted such complaints about delays proved the law was doing its job.

Paradise Lost: Parliament Amends the Procurement Law

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¶ 13. (SBU) According to Mart, the SGH responded to GOM complaints of too many project delays and cancellations by amending the procurement law in the last hours of its recently ended fall/winter session. Rather than accept MinFin's explanation that delays and cancellations argued that the law protected state interests and finances by slowing down illegal and poorly conceived projects (most of which Mart attributed to the SGH), SGH members opined that the law held back essential programs, frustrating the will of the people, harming the nation. Since the state had already budgeted some US\$350 million for projects in 2007 (mostly road and power

projects funded by the Windfall Profits Tax on copper and gold), MPs argued that it was essential to ensure these projects were funded and executed within the 2007 fiscal year.

¶14. (SBU) The newly amended procurement law has two provisions that disturb Mart. First, the amended law specifically exempts power and transport projects from competitive procedures. In these two sectors, ministries may procure the services for the GOM by direct contracting for projects under US\$10 million and where local capacity is lacking, which covers 999 out the 1,000 projects budgeted for fiscal year 2007. Mart explained how this new system would work. Let's say that Ministry of Roads, Transport and Tourism (MRTT) will fund five road projects for US\$5 million each. If there are four Mongolian firms that can satisfy the technical specifications, then these four will each receive a contract. Even if one firm stands head and shoulders above the rest in its technical capacities and ability to deliver quality goods and services at the lowest cost, the SGH aims to spread the bounty among all "capable" local firms. However, the MRTT minister will have prerogative of directing the fifth contract to whomever he thinks capable because local capacity (Mongolia's four firms) is insufficient to meet state procurement needs. Mart also thought the amendments might allow a minister to award all contracts according to his dictate if he determined that no local capacity exists whatsoever. Mart commented that this new provision sets Mongolia's procurement system back to the corrupt days of the 90's.

ULAANBAATAA 00000160 004 OF 004

¶15. (SBU) Mart also bluntly criticized provisions barring international competitors from participating in government procurements US\$10 million and under. According to Mart, the SGH enacted this amendment because it felt that the current law unfairly helped foreigners. The SGH based this judgment on the fact that Mongolians often did not win or compete on many of the large procurements. Mart argues the failure here was not the old procurement law but that Mongolian firms lack the capacity to compete. That the amendments will not change this fundamental situation was ignored by the SGH. Mart also stated that there was nothing in the law that prevented a winning Mongolian bidder from subcontracting out his rights to third party capable of delivering the service. In fact, the winner bidders would have to do if they could not deliver the project on their own steam, adding extra opportunities for corruption and waste.

¶16. (SBU) Mart was also concerned that the US\$10 million ceiling might violate Mongolia's WTO commitments under the plurilateral and optional General Procurement Agreement (GPA). Mart noted that only one out of the thousand projects budgeted for 2007 would break the US\$10 million exclusion set in the amended law. (Note: Mongolia is not a member but an observer to the agreement. The WTO GPA allows signatories to limit international competition in government procurement only on projects less than or equal to Euro 6 million, about US\$7.9 million. Although GPA disciplines aren't required of Mongolia, the high bar to international competition seems at variance with Mongolia's stated policy to have free trade with the U.S. and its other third neighbors.)

¶17. (SBU) Mart also criticized the legislative process that produced the amendments. She noted that review of the bill took only thirty days and involved absolutely no public notification or discussion of the amendments with any of the stakeholders. There was no mention in any of the media. She took her concerns to the SGH, her minister, and to the Ministry of Industry and Trade but got no traction on her concerns. Neither the World Bank nor the ADB was informed or learned of the proposals until the last minute and post only learned of the law after the fact.

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